

# **KERN COUNTY**

Audit Report

## **PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM**

*July 1, 2009, through June 30, 2012*



**JOHN CHIANG**  
California State Controller

April 2014



**JOHN CHIANG**  
**California State Controller**

April 4, 2014

The Honorable Mary B. Bedard, Auditor-Controller  
Kern County  
1115 Truxtun Avenue, 2<sup>nd</sup> Floor  
Bakersfield, CA 93301

Dear Ms. Bedard:

The State Controller's Office audited the methods employed by Kern County to apportion and allocate property tax revenues for the period of July 1, 2009, through June 30, 2012. The audit was conducted pursuant to the requirements of Government Code section 12468.

Our audit found that the county complied with California statutes, except that it:

- Included multi-county schools in the supplemental apportionment and negative Educational Revenue Augmentation Fund (ERAF) Vehicle License Fee (VLF) adjustment. The county also used pre-ADA factors for the negative ERAF VLF computation.
- Included the ERAF in the unitary and operating nonunitary apportionment.
- Included all school entities in the allocation of Qualified Electric property tax revenues, rather than only those affected school entities within the tax rate areas. Furthermore, the county recalculated the base factors each year, rather than calculating them for only the new Qualified Electric properties.
- Adjusted the SB2557 allocation factor for VLF and Sales and Use Tax.
- Did not grow the disaster relief adjustment from Fiscal Year (FY) 1997-98 through FY 2009-10. Furthermore, the county removed the disaster relief adjustment from the AB8 calculation beginning in FY 2010-11.
- Reversed all disaster relief adjustments from FY 1997-98 through FY 2009-10, removing \$3,295,805 from the ERAF, and distributing it to cities and the county.

If you have any questions, please contact Elizabeth González, Chief, Local Government Compliance Bureau, by telephone at (916) 324-0622.

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/kw

Honorable Mary B. Bedard,  
Auditor-Controller

-2-

April 4, 2014

cc: Janelle J. Austin, Accountant  
Kern County  
Leticia Perez, Chairperson  
Kern County Board of Supervisors  
Jody Martin, Principal Consultant  
Joint Legislative Budget Committee  
Peter Detwiler, Staff Director  
Senate Local Government Committee  
Elvia Dias, Committee Assistant  
Senate Local Government Committee  
Dixie Martineau-Petty, Secretary  
Assembly Local Government Committee  
Gayle Miller, Staff Director  
Senate Revenue and Taxation Committee  
Oksana Jaffe, Chief Consultant  
Assembly Revenue and Taxation Committee  
Neil McCormick, Executive Director  
California Special Districts Association  
Richard J. Chivaro, Chief Counsel  
State Controller's Office

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# Audit Report

## Summary

The State Controller's Office (SCO) audited the methods employed by Kern County to apportion and allocate property tax revenues for the period of July 1, 2009, through June 30, 2012.

Our audit found that the county complied with California statutes for the allocation and apportionment of property tax revenues, except that it:

- Included multi-county schools in the supplemental apportionment and negative Educational Revenue Augmentation Fund (ERAF) Vehicle License Fee (VLF) adjustment. The county also used pre-ADA (Average Daily Attendance) factors for the negative ERAF VLF computation.
- Included the ERAF in the unitary and operating nonunitary apportionment.
- Included all school entities in the allocation of Qualified Electric property tax revenues, rather than only those affected school entities within the tax rate areas. Furthermore, the county recalculated the base factors each year, rather than calculating them for only the new Qualified Electric properties.
- Adjusted the SB2557 allocation factor for the VLF and Sales and Use Tax (SUT).
- Did not grow the disaster relief adjustment from fiscal year (FY) 1997-98 through 2009-10. Furthermore, the county removed the disaster relief adjustment from the AB8 calculation beginning in FY 2010-11.
- Reversed all disaster relief adjustments from FY 1997-98 through FY 2009-10, removing \$3,295,805 from the ERAF, and distributing it to cities and the county.

Additionally, we noted that the County of Kern currently is in litigation with the City of Bakersfield about the County's interpretation of the Memorandum of Understanding for a jurisdictional change. Therefore, the SCO will make a determination on the jurisdictional issue at such time as the litigation as well as any appeals are resolved.

## Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for allocating and apportioning property tax revenues to local government agencies and public schools. The main objective was to provide local government agencies with a property tax base that would grow as assessed property values increased. These methods have been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill (AB) 8, Chapter 282, Statutes of 1979, which established the method of allocating property taxes for FY 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

The property tax revenues that local government agencies receive each fiscal year are based on the amount received in the prior year, plus a share of the property tax growth within their boundaries. Property tax revenues are then apportioned and allocated to local agencies and schools using prescribed formulas and methods defined in the Revenue and Taxation Code.

The AB 8 base process involved numerous steps, including the transfer of revenues from schools to local agencies (AB 8 shift) and the development of the tax rate area annual tax increment apportionment factors (ATI factors), which determine the amount of property tax revenues to be allocated to each jurisdiction.

The total amount to be allocated to each jurisdiction is then divided by the total amount to be allocated to all entities to determine the AB 8 apportionment factor (percentage share) for each entity for the year. The AB 8 factors are computed each year for all entities, using the revenue amounts established in the prior year. These amounts are adjusted for growth annually, using ATI factors.

Subsequent legislation removed revenues generated by unitary and nonunitary properties, regulated railway companies, and qualified electric properties from the AB 8 process. These revenues are now allocated and apportioned under separate processes.

Other legislation established an Educational Revenue Augmentation Fund in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the fund. The fund is subsequently allocated and apportioned to schools by the county auditor according to instructions received from the county superintendent of schools or the State Chancellor of Community Colleges.

Revenues generated by the different types of property tax are apportioned and allocated to local agencies and schools using prescribed formulas and methods, as defined in the Revenue and Taxation Code. Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls maintained primarily by the county assessor. Tax rolls contain an entry for each parcel of land, including the parcel number, the owner's name, and the value. Following are the types of property tax rolls:

- *Secured Roll*—This roll contains property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if necessary, can be sold by the tax collector to satisfy unpaid tax levies.
- *Unsecured Roll*—This roll contains property that, in the opinion of the assessor, does not have sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.

- *State-Assessed Roll*—This roll contains public utility and railroad properties, assessed as either unitary or nonunitary property by the State Board of Equalization.
- *Supplemental Roll*—This roll contains property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

To mitigate problems associated with the apportionment and allocation of property taxes, Senate Bill 418 was enacted in 1985 requiring the State Controller to audit the counties' apportionment and allocation methods and report the results to the California State Legislature.

## **Objective, Scope, and Methodology**

Our audit objective was to review the county's apportionment and allocation of property tax revenues to local government agencies and public schools within its jurisdiction to determine whether the county complied with Revenue and Taxation Code requirements.

To meet the objective, we reviewed the county's procedures for apportioning and allocating property tax revenues used by the county auditor and the processes used by the tax collector and the assessor.

We performed the following procedures:

- Conducted tests to determine whether the county correctly apportioned and allocated property tax revenue.
- Interviewed key personnel and reviewed supporting documentation to gain an understanding of the county's property tax apportionment and allocation processes.
- Reviewed apportionment and allocation reports prepared by the county showing the computations used to develop the property tax distribution factors.
- Reviewed tax rate area reports to verify that the annual tax increment was computed properly.
- Reviewed county unitary and operating nonunitary reports and Board of Equalization reports and verified the computations used by the county to develop the unitary and operating nonunitary property tax distribution factors.
- Reviewed successor agency Recognized Obligation Payment Schedule (ROPS) and county apportionment and allocation reports addressing payments to the Redevelopment Property Tax Trust Fund.
- Reviewed property tax administration cost reports prepared by the county and verified administrative costs associated with procedures used for apportioning and allocating property tax to local government agencies and school districts.

- Reviewed ERAF reports prepared by the county and verified the computations used to determine the shift of property taxes from local agencies to the ERAF and, subsequently, to public schools.
- Reviewed reports and computations prepared by the county to determine any increases in property tax revenues due cities having low or non-existent property tax amounts.

We conducted this performance audit under the authority of Government Code sections 12468 and 12410. We did not audit the county's financial statements. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit covered the period of July 1, 2009, through June 30, 2012. Our audit scope was limited to:

- Reviewing operational procedures and significant applicable controls over the apportionment and allocation process;
- Examining selected property tax apportionment and allocation records; and
- Reviewing related property tax revenue data used to determine the apportionment and allocation computation process.

A property tax bill contains the property tax levied at a 1% tax rate pursuant to the requirement of Proposition 13. A bill may also contain special taxes, debt services levies on voter-approved debt, fees, and assessments levied by the county or a city. The scope of our audit was concerned with the distribution of the 1% tax levy. Special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city are beyond the scope of our audit and were not reviewed or audited.

We limited our review of the county's internal controls to gaining an understanding of the transaction flow in order to develop appropriate auditing procedures. We did not evaluate the effectiveness of all internal controls.

In addition, we tested transactions used to apportion and allocate property taxes and performed other procedures deemed necessary. This report relates solely to the method used by the county to apportion and allocate property taxes.



**Conclusion**

Our audit found that, except for the items discussed in the Findings and Recommendations section of this report, Kern County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2009, through June 30, 2012. The county should correct the items discussed in the Findings and Recommendations section.

Additionally, we noted that the County of Kern is in litigation with the City of Bakersfield about the County's interpretation of the Memorandum of Understanding for a jurisdictional change. Therefore, the SCO will make a determination on the jurisdictional issue at such time as the litigation has ended.

**Follow-up on Prior Audit Findings**

Findings noted in our prior audit, issued April 2010, have been satisfactorily resolved by the county, with the exception of Finding 4.

**Views of Responsible Officials**

We issued a draft audit report on February 7, 2014. Mary B. Bedard, Auditor-Controller, responded by letter dated February 21, 2014 (Attachment). She agreed with the audit results.

**Restricted Use**

This report is solely for the information and use of the County, the California Legislature, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

April 4, 2014

# Findings and Recommendations

## **OBSERVATION 1— Jurisdictional changes**

Kern County has had Memorandums of Understanding (MOUs) with the cities in the county regarding the annexation of county unincorporated areas into the cities since 1995.

Prior to fiscal year (FY) 2012-13, the county computed city annexations using only the city/county split percentages noted in the respective MOU to determine revenue and factor shares.

Prior to our audit of the Kern County Property Tax Procedures in May 2013, the SCO had been contacted by Kern County and the City of Bakersfield regarding the application of the MOU. Specifically, they were concerned with Educational Revenue Augmentation Fund (ERAF) adjustments and the proposal by the county to adjust the computation of city annexations completed since FY 2005-06.

The county has determined that it has been misinterpreting the MOU concerning the ERAF adjustment of revenue to be exchanged. The city disagrees with the county's interpretation and adjustment of annexations since FY 2005-06.

The City of Bakersfield filed suit against the county regarding the county's interpretation of the MOU.

## **FINDING 1— Supplemental property tax**

The county included multi-county schools in the supplemental apportionment and negative ERAF Vehicle License Fee (VLF) adjustment. The county also used pre-Average Daily Attendance (ADA) factors for the negative ERAF VLF computation.

The legal requirements for supplemental roll property tax apportionment and allocation are found in Revenue and Taxation Code sections 75.60 through 75.71, and 100.2. When there is a change in assessed property value due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property for the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

### Recommendation

The county should exclude multi-county schools in all future supplemental apportionments and negative ERAF VLF adjustments. The county also must use post-ADA factors for future negative ERAF VLF computations.

### County's Response

We concur and have made the corrections beginning with 2013-14.

SCO Comment

The SCO will review the corrections in the next audit.

**FINDING 2—  
Unitary and operating  
nonunitary  
apportionment**

The County included the ERAF in the unitary and operating nonunitary apportionment.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code (R&T Code) section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

For all future unitary and operating nonunitary tax apportionment computations, the county should not include the ERAF.

County’s Response

In accordance with the current position of the State Auditor’s Association, we concur and will make the necessary revisions for 2014-15.

SCO Comment

The SCO will review the corrections in the next audit.

**FINDING 3—  
Unitary Qualified  
Electric property  
apportionment**

The county included all school entities in the allocation of Qualified Electric property tax revenues, rather than only those affected school entities within the tax rate areas. Furthermore, the county recalculated the base factors each year, rather than calculating them for only the new Qualified Electric properties.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in R&T Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

#### Recommendation

The county should recalculate the Qualified Electric apportionment factors, beginning in FY 2009-10, to include only the affected school entities within the tax rate areas. Furthermore, the county should only calculate base factors in a year in which there are new Qualified Electric properties, and only for those new tax rate areas.

#### County’s Response

We concur and have made the necessary corrections.

#### SCO Comment

The SCO will review the corrections in the next audit.

### **FINDING 4— Property tax administrative costs**

The county adjusted Property Tax Administrative Fee allocation factors for the VLF and Sales and Use Tax (SUT), substantially increasing the amount of proportionate costs to cities.

Requirements for the reimbursement of county property tax administrative costs are found in Revenue and Taxation Code section 95.3. County property tax administrative costs are incurred by the assessor, the tax collector, the assessment appeals board, and the auditor-controller. The county is allowed, depending on the fiscal year and any corresponding exclusions, to be reimbursed by local agencies and public schools for these administrative costs.

#### Recommendation

The VLF and SUT should not be included in the administrative costs computation. It was noted that the county deposited the disputed amounts charged into an impound account. The county should refund the over-charged amounts back to the cities.

### County's Response

This office originally did not change the PTAF calculation, but felt obligated to make the revisions and place the money in trust, pending the appeal, once the superior court ruled in favor of the County of Los Angeles' calculation method in the case of City of Alhambra v County of Los Angeles. The Court of Appeal reversed that decision, and in late 2012 the California Supreme Court upheld the decision by the Court of Appeal. In 2013 this office refunded the overcharged amounts to the cities.

### SCO Comment

The SCO will review the corrections in the next audit.

## **FINDING 5— Educational Revenue Augmentation Fund (ERAF)**

The county did not grow the disaster relief adjustment from FY 1997-98 through FY 2009-10. Furthermore, the county removed the disaster relief adjustment from the AB 8 calculation beginning in FY 2010-11.

The county also reversed all disaster relief adjustments from FY 1997-98 through FY 2009-10, removing \$3,295,805 from the ERAF, and distributing the funds to cities and the county (Schedule 1).

Requirements for the local agency shift of property tax revenues to the ERAF aka ERAF Shift are found in Revenue and Taxation Code sections 97.1 through 97.3.

In addition to the ERAF Shift, R&T Code section 97.2 requires a Disaster Relief Adjustment, beginning in the 1992-93 fiscal year. The adjustment was a reduction to the amount of reduced city and county funds that were redirected to the ERAF. This reduction is continued, without growth, through the 1996-97 fiscal year.

In FY 1997-98, the Disaster Relief Adjustment is reversed (from here on referred to as the Disaster Relief Reversal), shifting revenue from the county and cities to the ERAF. During that year, the disaster relief reversal is multiplied by the FY 1992-93 over FY 1991-92 growth.

In FY 1998-99, disaster relief reversal is included as part of the ERAF Shift defined by Revenue and Taxation Code 97.2(e)(3), which states:

For purposes of allocations made pursuant to section 96.1 for the 1998-99 fiscal year, the amount allocated from the Educational Revenue Augmentation Fund pursuant to this subdivision shall be deemed property tax revenues allocated to the Educational Revenue Augmentation Fund in the prior fiscal year.

Therefore, in FY 1998-99, the prior year disaster relief reversal is deemed to be revenue allocated to the ERAF in that year, and is added to the ERAF shift base, prior to the FY 1998-99 adjustment for growth. Consequently, the disaster relief reversal is grown every year thereafter, as it is included as part of the ERAF base.

Recommendation

The county should adjust the ERAF base in FY 1998-99 to include the FY 1997-98 disaster relief adjustment, prior to the FY 1998-99 adjustment for growth. The county should recalculate the ERAF amount in all subsequent years and use the adjusted ERAF amount going forward.

The county should transfer to the ERAF any underallocated amounts, beginning with FY 2005-06 (totaling approximately \$2,732,584).

The county also should transfer to the ERAF the amounts reclassified in error in FY 2009-10 (totaling \$3,295,805).

County's Response

We concur and used the corrected ERAF amount beginning in 2013-14. We have begun the transfer to ERAF of the underallocated amounts from 2005-06 – 2012-13 as well as the amounts reclassified in error in FY 2009-10. In accordance with Revenue and Taxation Code 96.1(c)(3), this will be accomplished over a three year period.

SCO Comment

The SCO will review the corrections in the next audit.

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**Schedule 1—  
Summary of Misallocations to the  
Educational Revenue Augmentation Fund  
July 1, 2009, through June 30, 2012**

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Finding No.	Years Affected	Amount Due to (owed from) the ERAF
5	2005-06 through 2011-12	\$ 6,028,389
Totals		\$ 6,028,389 <sup>1</sup>

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<sup>1</sup> See the Findings and Recommendations section, Finding 5.

Revenue and Taxation Code 96.1(b) states, “Any allocation of property tax revenue that was subjected to a prior completed audit by the Controller, pursuant to the requirements of Section 12468 of Government Code, where all findings have been resolved, shall be deemed correct.”

The SCO’s audit of the Kern County Property Tax Allocation System from July 1, 2001, to June 30, 2005, concluded that the county complied with California statutes for the allocation and apportionment to property tax revenues for the period audited.

While in certain cases it is necessary to begin corrective calculations prior to this period, any actual allocation adjustments are limited to the 2005-06 fiscal year.

**Attachment—  
County's Response to  
Draft Audit Report**

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**Mary B. Bedard, CPA**  
**Auditor-Controller-County Clerk**

**KERN COUNTY AUDITOR-CONTROLLER-COUNTY CLERK**

1115 Truxtun Avenue, 1st and 2nd Floor • Bakersfield, CA 93301-4639

February 21, 2014

State Controller's Office, Division of Audits  
Attn: Elizabeth Gonzalez, Chief, Local Government Compliance Bureau  
PO Box 942850  
Sacramento, CA 94250-5874

Re: PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM AUDIT REPORT  
JULY 1, 2009 – JUNE 30, 2012

Dear Ms Gonzalez:

We have reviewed the draft audit report for the property tax apportionment and allocation system for Kern County. The following are our responses to the audit findings.

Finding 1. The county included multi-county schools in the supplemental apportionment and negative ERAF Vehicle License Fee (VLF) adjustment. The county also used pre-Average Daily Attendance (ADA) factors for the negative ERAF VLF computation.

**Response:**

We concur and have made the corrections beginning with 2013-14.

Finding 2. The county included the ERAF in the unitary and operating nonunitary apportionment.

**Response:**

In accordance with the current position of the State Auditor's Association, we concur and will make the necessary revisions for 2014-15.

Finding 3. The county included all school entities in the allocation of Qualified Electric property tax revenues, rather than only those affected school entities within the tax rate areas. Furthermore, the county recalculated the base factors each year, rather than calculating them for only the new Qualified Electric properties.

**Response:**

We concur and have made the necessary corrections.

Finding 4. The county adjusted Property Tax Administrative Fee allocation factors for the VLF and Sales and use Tax (SUT), substantially increasing the amount of proportionate costs to cities.

**Response:**

This office originally did not change the PTAF calculation, but felt obligated to make the revisions and place the money in trust, pending the appeal, once the superior court ruled in favor of the County of Los Angeles' calculation method in the case of City of Alhambra v County of Los Angeles. The Court of Appeal reversed that decision, and in late 2012 the California Supreme Court upheld the decision by the Court of Appeal. In 2013 this office refunded the overcharged amounts to the cities.

Finding 5. The county did not grow the disaster relief adjustment from FY 1997-98 through FY 2009-10. Furthermore, the county removed the disaster relief adjustment from the AB 8 calculation beginning in FY 2010-11.

The county also reversed all disaster relief adjustments from FY 1997-98 through FY 2009-10, removing \$3,295,805 from the ERAF, and distributing the funds to cities and the county.

**Response:**

We concur and used the corrected ERAF amount beginning in 2013-2014. We have begun the transfer to ERAF of the underallocated amounts from 2005-06 – 2012-13 as well as the amounts reclassified in error in FY 2009-10. In accordance with Revenue and Taxation Code 96.1(c)(3), this will be accomplished over a three year period.

Observation 1. Jurisdictional changes.

**Response:**


We would like to clarify this issue as stated in the audit report. The County of Kern Board of Supervisors has had Memorandums of Understanding (MOUs) with the cities in the county regarding the annexation of county unincorporated areas into the cities since 1995. The Kern County Auditor-Controller is responsible for properly apportioning property taxes and it was the Auditor-Controller's determination that this office had been incorrectly apportioning property taxes under the terms of the MOUs between the County of Kern and the cities. The SCO auditors reviewed the annexations that occurred during the audit period as well as the corrections this office made subsequent to the audit period. As is the SCO's practice, the auditors did discuss with us various findings throughout the course of the audit, including their findings related to the annexation issue.

However, the city of Bakersfield disagrees with the Auditor-Controller's decision and adjustment of annexations since FY 2005-06 and filed suit against the County of Kern and the Auditor-Controller. Due to the litigation, the SCO audit does not include their determination regarding the jurisdictional change issue.

State Controller's Office  
February 21, 2014  
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We appreciate the opportunity to address the proposed findings and look forward to the SCO making public your determination on the jurisdictional change issue once the litigation is resolved. If you wish to discuss our responses further please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink that reads "Mary B. Bedard". The signature is written in a cursive, flowing style.

Mary B. Bedard, CPA  
Auditor-Controller-County Clerk

**State Controller's Office  
Division of Audits  
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